IT 00-11
Tax Type: **Income Tax**
Issue: **Allowable Deductions**
Qualified Medical Plan

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,

v.

"SAMUEL & SUSAN SMITH",
Taxpayer

No. 98-IT-0000
SSN #000-00-0000
Tax Years 1997, 1998, 1999

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Taxpayer appeared *pro se*.

Synopsis:

This matter is before this administrative tribunal as the result of timely protests by "Samuel and Susan Smith" (hereinafter referred to as the "taxpayer") of the Illinois Department of Revenue's (hereinafter referred to as the "Department") denial of the taxpayer's claims for refund. These claims seek to reduce the taxpayer's income tax due for the tax years ending December 31, 1997, 1998 and 1999. Mr. "Smith" contends that he is entitled to deduct disability insurance benefits in determining his tax liability for 1997. Mr. "Smith" has previously adjudicated this contention before this tribunal, and a

ruling on this issue in favor of the Department was issued on May 18, 1999. Mr. "Smith" also contends that he is entitled to deduct medical costs in determining his tax liability for 1998 and 1999. The Department has refused to grant the taxpayer the relief requested for 1997 because the disability benefit the taxpayer seeks to deduct was not received from a "qualified" benefit plan. The Department has also refused to grant the taxpayer the relief requested for 1998 and 1999 because medical expenses are not allowable deductions in determining the tax due. A hearing was held regarding this matter on July 19, 2000. At the hearing, the taxpayer advanced several arguments for the allowance of a deduction for disability benefits and medical expenses. Following a careful review of these arguments and the file, including all documents and correspondence, I have concluded that I cannot recommend the relief the taxpayer requests, and that the Department's determination should be finalized as issued.

Findings of Fact:

1. The Department's *prima facie* case consisted of letters of determination issued October 29, 1998, April 26, 2000 and May 3, 2000 denying taxpayer's refund claims on Form 1040X for tax years 1997, 1998 and 1999. Dept. Ex. 1.
2. The taxpayer filed a Form 1040X for 1997. The taxpayer subtracted $15,725 on line 5 of the Form 1040X as "Federally taxed retirement and social security". The taxpayer's IL 1040X shows no tax liability and claims a refund of $238. Taxpayer's Group Ex. 1.
3. On October 29, 1998 the Department issued a determination for tax year 1997 denying the taxpayer a refund claim. Dept. Ex. 1.

4. The taxpayer filed a Form 1040X for 1998, on which the taxpayer subtracted $11,351 on line 9. The taxpayer's IL 1040X shows no liability and claims a refund due of $246. Taxpayer's Group Ex. 1.
5. On April 26, 2000, the Department issued a determination for tax year 1998 denying the taxpayer's refund claim. Dept. Ex. 1.
6. The taxpayer filed a Form IL 1040X for 1999, on which the taxpayer subtracted $11,815 on line 9. The taxpayer's IL 1040X shows no liability and claims a refund of $83. Taxpayer's Group Ex. 1.
7. On May 3, 2000, the Department issued a determination for tax year 1999 denying the taxpayer's refund claim. Dept. Ex. 1.

Conclusions of Law:

At issue in this case is whether the taxpayer can deduct disability insurance benefits received from a non-qualified plan in determining his Illinois income tax due for 1997, and whether the taxpayer can deduct medical expenses in determining his Illinois income tax due for 1998 and 1999. The Department determined that the taxpayer could not take these deductions. Section 904(a) of the Illinois Income Tax Act, 35 **ILCS** 5/904 provides that the Department's *prima facie* case is established by the admission into evidence of the Department's determination of the correct amount of tax due. *See* Balla v. Dept. of Revenue, 96 Ill. App. 3d 293 (lst Dist. 1981).

35 **ILCS** 5/203(a)(2)(F) of the Illinois Income Tax Act permits individuals to deduct amounts received as distributions from employee benefit plans. However, this deduction is allowed *only* if the distribution is from a *qualified* employee benefit plan as defined in sections 402 through 408 or 457 of the Internal Revenue Code. *Id.* The

taxpayer has presented no evidence that the benefit payments he received in 1997 were from a qualified employee benefit plan. Mr. "Smith" nevertheless believes that he is entitled to deduct these benefit distributions. He advances several arguments in support of his position.

Mr. "Smith" principal contention is that he is entitled to deduct the insurance proceeds he received because all disability insurance proceeds are deductible. The statutory deduction the he relies upon to support this position is allowed by portions of 35 ILCS 5/203(a)(2)(F) authorizing a deduction from Adjusted Gross Income ("AGI") for "distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit". This statutory provision clearly limits the deduction the taxpayer seeks to take to distributions from government disability plans. The taxpayer nevertheless contends that he is entitled to deduct payments from a private disability plan not provided by any government agency based on the instructions for completing line 5 of form IL 1040 indicated on the taxpayer's 1997 Illinois income tax return form. These instructions allow a deduction for "a government retirement or disability plan including military plans". The taxpayer vehemently contends that these instructions should be construed to allow a deduction for any disability plan payment, whether or not the disability plan is provided by the government. The taxpayer's reading of these instructions is clearly erroneous. To construe this language to cover all disability plan payments, one must ignore the words "including military plans" appearing at the end of the instructions. The phrase "including military plans" in the 1997 instructions obviously modifies all of the terms in the instructions that precede it. Given the

foregoing, these instructions cannot possibly be construed to cover disability plans provided by private employers.

Finally, the taxpayer, a person not unfamiliar with Illinois tax statutes, clearly could have avoided being misled by reading the statutory provision authorizing the deduction the taxpayer seeks to take. As previously noted, the statute clearly and unambiguously provides that only government disability plan distributions qualify for deduction. For the foregoing reasons, the taxpayer's contention that he is entitled to the deduction for government disability plan distributions provided by 35 **ILCS** 5/203(a)(2)(F) must be rejected.

Mr. "Smith" also argues that disability benefits cannot be taxed in Illinois because, unlike the Internal Revenue Code, the Illinois Income Tax Act does not tax retirement benefits. He also contends that Illinois law was never affirmatively amended to conform to the Internal Revenue Code when the Code was changed in 1983 to include disability benefits in Federal AGI, and that Illinois therefore has no authority to tax these benefits. These arguments fail to recognize that Illinois uses Federal AGI as the starting point to compute Illinois taxable income. See 35 **ILCS** 5/203(a)(1). The disability insurance distributions at issue here were included in the taxpayer's Federal AGI and therefore included on line 1 of the taxpayer's 1040X for 1997. Because Illinois uses Federal AGI as the starting point to compute Illinois income tax, including these amounts in computing the taxpayer's tax due to Illinois did not violate Illinois law. *Id.* For the reasons enumerated above, the taxpayer has failed to establish that he is entitled to deduct disability benefits received from a nonqualified plan in computing the taxpayer's 1997 Illinois income tax.

Mr. "Smith" also argues that taxing his disability income violates basic principles of insurance law and taxation. This argument is based on Section 104 of the Internal Revenue Code, which excludes from income recoveries received on account of personal injury or sickness. Internal Revenue Code Section 104(a)(3) (excludes "amounts received through accident or health insurance for personal injuries or sickness"). This argument addresses the issue of whether Mr. "Smith's" disability income should be included in the AGI on his Federal income tax return. From a state tax standpoint, once these amounts were included in the taxpayer's Federal AGI, they could not be excluded from the taxpayer's Illinois AGI because Illinois uses Federal AGI as the starting point to compute taxable income. 35 **ILCS** 5/203(a)(1).

The taxpayer did not deduct disability insurance proceeds in determining his taxable income on his 1998 and 1999 return. However, Mr. "Smith" testified that he deducted medical expenses on amended returns filed for these tax periods on line 9 of these returns. Mr. "Smith" argues that he is entitled to deduct medical expenses as a "cost" of producing disability income. However, he cites no authority for this proposition other than the "Income Principle" which he maintains is the basis for all federal and state taxation. See taxpayer's 1998 protest dated April 30, 2000.

When a taxpayer seeks to take advantage of a deduction or credit allowed by statute, the burden of proof is on the taxpayer, as deductions are privileges created by statute as a matter of legislative grace. Bodine Electric Co. v. Allphin, 81 Ill. 2d 502 (1980); Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1st Dist. 1981). Here, Mr. "Smith" has not cited any case or statute, or provided any other proof that his medical

expenses fall within any category of expense allowed as a deduction by the Illinois Income Tax Act.

Mr. "Smith" has repeatedly maintained that not allowing him to take a deduction for disability plan payments from a non-qualified plan and for medical expenses discriminates against disabled persons including himself. This argument ignores the fact that no one (including any disabled person) is allowed to take these deductions. Allowing the taxpayer to take these deductions while disallowing them to everyone else would arbitrarily and capriciously discriminate in favor of the taxpayer in violation of the equal protection clause of the U.S. Constitution. *See* Kerasotes Rialto Theater Corporation v. City of Peoria, 77 Ill. 2d 491 (1979).

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's denial of the taxpayer's claims be upheld.

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Ted Sherrod
Administrative Law Judge

Date: July 28, 2000